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No. 86-961

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1986

CAMPBELL SALES COMPANY,

*Petitioner,*

—v.—

NEW YORK STATE TAX COMMISSION,

*Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

## REPLY BRIEF OF PETITIONER

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## PARTIES TO THE PROCEEDING

A statement of the parties to this proceeding and a listing of the subsidiaries of Campbell Soup Company, the parent of the petitioner, was set forth on page ii of the petition, pursuant to Rule 28.1 of the Court's rules.

## TABLE OF CONTENTS


| | Page |
|---|---|
| PARTIES TO THE PROCEEDING | i |
| TABLE OF CONTENTS | ii |
| TABLE OF AUTHORITIES | iii |
| ARGUMENT | 1 |
| I. WHETHER THE NEW YORK TAX IS OUT OF ALL PROPORTION TO THE ACTIVITIES OF CAMPBELL SALES IN NEW YORK IS MEASURED BY COMPARING THE NEW YORK TAX ON CAMPBELL SALES ON A SINGLE CORPORATION RETURN BASIS WITH THE NEW YORK TAX ON CAMPBELL SALES ON A COMBINED RETURN BASIS. | 4 |
| II. RECEIPTS FROM THE SHIPMENT OF GOODS FROM OUT OF STATE TO AN INDEPENDENT THIRD PARTY IN NEW YORK BY A PARTY WHICH IS NOT SUBJECT TO NEW YORK TAX CANNOT BE USED AS THE BASIS FOR TAXING THE OUT-OF-STATE SHIPPER | 6 |
| III. CAMPBELL SOUP DOES NOT MAINTAIN AN OFFICE OR SOLICIT IN NEW YORK AND TO THE EXTENT THAT THE TAX IMPOSED BY NEW YORK IS BASED ON RECEIPTS OF CAMPBELL SOUP FOR GOODS SHIPPED FROM OUT OF NEW YORK TO INDEPENDENT CUSTOMERS IN NEW YORK IT VIOLATES PUBLIC LAW 86-272 | 8 |
| CONCLUSION | 9 |

## TABLE OF AUTHORITIES


| Cases | Page |
|---|---|
| *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983) | 4, 5, 6 |
| *In re Appeal of Joyce, Inc.* 1966 Calif. St. Tax Rep. (CCH) ¶ 203-523 (California State Bd. of Equalization) | 9 |
| *Northwestern States Portland Cement Company v. State of Minnesota*, et al., 358 U.S. 450 (1959) | 5 |
| **Federal Statutes:** | |
| Interstate Commerce Tax Act, Pub.L.No. 86-272, 15 U.S.C.A. § 381 *et seq.* (1976) | 3, 8, 9 |
| 14th Amendment to the United States Constitution | 4 |

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The State (Respondent) here, as below, confuses the facts and the issues in this case so as to avoid a hearing on the critical and important Constitutional and Federal statutory issues

involved, which the New York Court of Appeals ignored (but which the New York intermediate appeals court – The Appellate Division, Supreme Court – recognized). We will not attempt to correct the several factual errors in the State's answering brief which imply that Campbell Soup may be subject to New York tax. The undisputed fact is that Campbell Soup is not subject to New York State income/franchise tax and the State concedes in its brief (p. 14) that "[t]he tax here is only on (Campbell) Sales," which has been in business since 1922 and has been subject to New York tax since 1941. In the 55th year of Campbell Sale's existence and after 35 years of filing New York income tax returns on a single corporation basis[1], New York (without the benefit of any change in its own or the Federal law or Constitutional interpretation) for the first time takes the position that a combined return with Campbell Soup is necessary to properly reflect the New York tax because (in the words of the New York statute) of intercompany transactions between the two companies.

The State in substance concedes that the tax on Campbell Sales on a single corporation basis (and without a combined return) accurately reflects the activities of Campbell Sales in New York and, indeed, the Tax Commission held that the only intercompany transactions between Campbell Soup and Campbell Sales were on the equivalent of an arm's-length basis and that the tax on a single return basis properly reflected such activities.

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[1] Since such date (1941), Campbell Sales has filed a New York State franchise/income tax return as a single corporate taxpayer and has paid New York State tax based on an agreed-upon adjusted formula. While the tax paid in the several years preceding the year in issue here is more than on the basis of the New York statutory formula, the record does not reflect whether the taxes in the earlier years were more or less than the tax under the statutory formula. The record does, however, reflect that the tax was paid pursuant to an agreement and not voluntarily; and, while the agreement was in effect, the question of whether such tax was more or less than the amount determined under the statutory formula was irrelevant. What is relevant is the fact that the State revoked the agreement for 1977 and the parties are therefore left to the statute as to what is and is not permissible or appropriate.

The record also shows the tax on Campbell Sales on a combined return basis is 58 times more than the tax on a single corporation return basis. The activities of Campbell Sales in New York are not changed by being subject to a combined return – only the measure of its income and the portion thereof apportionable to New York and subject to New York tax are changed by a combined return.

Campbell Soup had no New York activities which would subject it to tax prior to the inclusion of its income in a (combined) return of Campbell Sales and the filing of a combined return does not in any way change the activities of Campbell Soup, *vis a vis*, New York or otherwise.

In light of these clear, concise and undisputed facts, we submit that the legal position applied to such facts as set forth in the opinion of the Court of Appeals of New York is untenable under Federal Constitutional and statutory standards, and because of the important implications of this case in relation to state taxation and, in particular, taxation on a unitary basis, the petition for *certiorari* should be granted. Moreover, the position taken by the State for the first time in its answering brief here that goods shipped by a party not otherwise subject to tax (Campbell Soup) to independent third-party customers in New York gives rise to taxation of the shipper (Campbell Soup) in the destination state (New York) by virtue of the use of the unitary method, is also, we believe, a case of first impression for this Court.

Also, as noted in the petition, the question dealing with the application of Public Law 86-272 to combined return and/or unitary tax principles is, we believe, a case of first impression before this Court.

Our specific responses to the position of New York set forth in its answering brief are set forth below.

## I. WHETHER THE NEW YORK TAX IS OUT OF ALL PROPORTION TO THE ACTIVITIES OF CAMPBELL SALES IN NEW YORK IS MEASURED BY COMPARING THE NEW YORK TAX ON CAMPBELL SALES ON A SINGLE CORPORATION RETURN BASIS WITH THE NEW YORK TAX ON CAMPBELL SALES ON A COMBINED RETURN BASIS.

The New York tax on Campbell Sales on a combined (with Campbell Soup) return basis is 58 times more than the New York tax on Campbell Sales on a single corporation return basis. Under the standard expressed in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 184 (1983), this tax is clearly out of all proportion to the activities of Campbell Sales in New York and, therefore, violative of the due process clause of the United States Constitution.

New York's response is that the tax on a combined return basis must be measured against what the tax would be if there were only one corporation involved (i.e., if Campbell Soup and Campbell Sales were one corporation). This, of course, presents no measuring rod at all because the very thing being measured would always be the same in both cases. The fact is that while income of more than one corporation is included in a combined return, *the activities in New York remain the activities of one corporation taxable in New York, namely, Campbell Sales. Campbell Soup does not have activities taxable in New York on account of the filing of a combined return.* In other words, the filing of a combined return or measuring income on a unitary basis does not change the basic underlying facts as to which activities are carried on in the State.

If Campbell Soup Company had taxable activities in New York, New York State could impose a tax directly on Campbell Soup without the need of going through the indirect route of a combined return. Being unable to tax Campbell Soup because of the limitations of its own law and of the Federal Constitution, New York here seeks to include the activities of Campbell Soup, which activities are in both fact and substance outside

of New York, as part of the activities of Campbell Sales. The State confuses the ability to require Campbell Sales to include the income of Campbell Soup with its own under the unitary method with the treatment of non-New York activities of Campbell Soup as New York activities of Campbell Sales. The former is permissible; the latter is impermissible under any standard.

Campbell Soup, it must be remembered, accepts orders out of state and then ships goods from out of New York State to independent third parties in New York State. That activity is not an intercompany activity and not a taxable activity in New York and does not give New York the jurisdiction to tax Campbell Soup solely on that basis, even under *Northwestern States Portland Cement Company v. State of Minnesota*, et al., 358 U.S. 450 (1959).

In *Container Corp., supra*, the measuring rod was clearly set forth on page 184, on pages 174 and 175 and in footnotes 11 and 12, where the tax on a single return basis was compared to the tax on a combined return basis. Rather than use this obvious measuring rod, the State (in addition to its one corporation test referred to above) on page 13 of its brief seems to be saying that, so long as New York does not impose a tax on a percentage of the total combined income in excess of the percentage of combined sales to independent New York customers to total sales, it (New York) is safely within the bounds permitted by Constitutional standards. For a company like Campbell Soup, which has no property or payroll in New York and, indeed, is not subject to New York tax jurisdiction, this would mean that 100% of its net income may be apportioned to the destination state, while a New York taxpayer which ships out of state would have none of its income apportioned to New York. In other words, New York's view, as expressed in its brief, is that if 100% of sales were represented by shipments from out of state to independent New York customers, New York has the right to tax 100% of the shipper's income with no opportunity for the shipper to reflect the out-of-state (non-New York) activities that produced that product in the first place, which, in Campbell Soup's case, are all of its activities. This clearly is not the law. New York's attempt to apply the law in this manner through the combined return inclusion distorts the relevant

tax principles beyond recognition. The result of such distortion is a tax which is 58 time greater than the tax on a single corporation return basis and out of all proportion to the activities of Campbell Sales, the taxpayer, in New York.

## II. RECEIPTS FROM THE SHIPMENT OF GOODS FROM OUT OF STATE TO AN INDEPENDENT THIRD PARTY IN NEW YORK BY A PARTY WHICH IS NOT SUBJECT TO NEW YORK TAX CANNOT BE USED AS THE BASIS FOR TAXING THE OUT-OF-STATE SHIPPER.

The State in its brief (p. 11) states that the profit derived from the mark-up of goods sold and delivered to New York customers is subject to New York tax and (p. 12) that "if New York were not permitted to tax income derived from the sale of property shipped to New York, the income would not be taxed by any state."

Billions of dollars of goods are shipped into New York each year from parties in other states and other countries. If the shippers are not otherwise subject to New York tax, the shipment of goods into the State does not cause them to be subject to New York tax. Indeed, New York makes no attempt to tax them.

Whether those out-of-state shippers are subject to tax in their own jurisdictions is quite another matter, and whether they are or are not is not the basis for New York's determining whether it should impose a tax on such shippers. Thus, the statements in the State's brief about whether Campbell Sales may escape tax if New York does not impose the taxes levied here is entirely irrelevant to anything involved in this case. The New York Court of Appeals ignored this argument below and it should be ignored here. Furthermore, the record here does not reveal how much tax has been paid by Campbell Sales or Campbell Soup to the other states since it is irrelevant under New York law (and under *Container Corp.*, *supra*, at pages 169-171).

The fact of the matter is that New York, as many other states, by its own conscious political decision has decided to use a destination test in the receipts factor of the three-part formula.

Thus, New York, by its own motion, does not include in New York receipts the receipts from goods shipped by a New York taxpayer from New York to another state. The exclusion of such receipts of a New York shipper from the New York formula is not dependent on whether the destination state of the goods shipped by the New York taxpayer will tax such receipts, and certainly it is not based on an assumption that the destination state will impose a tax. Indeed, in most cases it is based on the opposite assumption — that the destination state will not impose a tax if the taxpayer is not otherwise doing business there. The underlying assumption is that this, in turn, allows the New York taxpayer to reduce its New York tax by shipping out of state — the destination test significantly dilutes the effect of having payroll and property in New York — businesses will be induced to establish facilities and payroll in New York.

Moreover, the double-weighting of sales in the three-part formula permits a New York taxpayer with facilities and employees in New York who ships out of state to receive a double bonus. Not only are receipts from out-of-state sales not counted as New York receipts but the importance of payroll and property is reduced from one-third each to one-fourth each. Of course, what is not paid by one taxpayer must usually be made up by another so that under the double-weighting for sales formula, a taxpayer which is subject to New York tax but whose percentage of property and payroll is below its sales percentage ends up paying more tax in New York than it would pay on the basis of the three-factor formula.

These, however, are political decisions which the states have every right to make. No one here questions the right of New York to use the destination test or to double-weight sales, even though such factors are more heavily weighted in favor of a taxpayer who manufactures in New York, and ships from New York to an out-of-state customer. What is involved here is an entirely different question, namely, whether New York can in substance impose a tax on a party not otherwise subject to tax merely because it has independent third parties as customers in New York to which it ships goods. New York concedes that

it cannot, in such case, impose a tax on the non-New York shipper directly. The question is whether through the mechanism of a combined return can it do indirectly what is clearly prohibited from doing on a direct basis without violating the United States Constitution in cases where, as here, the resulting tax is out of all proportion to the tax that would have been paid on a single corporation return basis.

## III. CAMPBELL SOUP DOES NOT MAINTAIN AN OFFICE OR SOLICIT IN NEW YORK AND TO THE EXTENT THAT THE TAX IMPOSED BY NEW YORK IS BASED ON RECEIPTS OF CAMPBELL SOUP FOR GOODS SHIPPED FROM OUT OF NEW YORK TO INDEPENDENT CUSTOMERS IN NEW YORK IT VIOLATES PUBLIC LAW 86-272.

As with its other arguments the State confuses the Public Law 86-272 issue. In its answer New York contends that, because Campbell Sales has an office in New York and is thus engaged in more than solicitation in New York it (Campbell Sales) is a New York taxpayer, and, therefore, Public Law 86-272 has no application. We agree. However, the State ignores the critical and relevant facts relating to this argument, which are:

1. Campbell Soup has no office in New York;

2. Campbell Soup itself does not solicit sales in New York;

3. Campbell Soup has never been a New York taxpayer;

and

4. Campbell Soup concededly is not a New York taxpayer now.

In short, Campbell Soup has not engaged in an activity which crosses the line established by Public Law 86-272. Therefore, it is clear that New York is essentially trying to ignore a corporate structure which has existed since 1922, which has always been recognized by New York and all other states.

The shipments by Campbell Soup from out of New York State to customers in New York State have always been insulated from tax under general jurisdictional principles and have also been insulated from tax under Public Law 86-272 since 1959, when such law was adopted. Since Campbell Soup has no activities in New York, to permit New York to take the receipts from those sales and include them in the receipts factor of Campbell Sales effectively negates the protection afforded by Public Law 86-272. Yet that is precisely what New York has done under the guise of a combined return. California has recognized the problem and its own Board of Tax Appeals (*In re Appeal of Joyce, Inc.* 1966 Calif. St. Tax Rep. (CCH) ¶ 203-523 (California State Bd. of Equalization)) has rejected an attempt by the state to effectively by-pass the Federal statute. The failure of the New York courts to do the same (or even recognize the problem), in our view, raises an important Federal question, which we believe is a question of first impression before this Court.

For this reason alone, the petition for *certiorari* should be granted.

## CONCLUSION

For the reasons stated herein and previously, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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